STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6417

Investigation into the existing rates of Waitsfield-Fayston Telephone Company, Inc.	))	Hearing at Montpelier, Vermont January 9, 2001

Order entered: 4/2/2001

PRESENT: Peter M. Bluhm, Hearing Officer

APPEARANCES: Alan B. George, Esq.
Keyser Crowley, P.C.
for Waitsfield-Fayston Telephone Company, Inc.

Dixie Henry, Esq.
John J. Cotter, Esq.
for Vermont Department of Public Service

I. SUMMARY

The Public Service Board ("Board") opened this docket to investigate the existing rates of Waitsfield-Fayston Telephone Company, Inc. ("Waitsfield" or the "Company") on September 11, 2000. Based on the evidence presented in this docket and on the stipulation of the parties, I conclude that a rate reduction of 12.65 percent and accompanying rate design changes proposed by the parties will produce just and reasonable rates. In support of that conclusion, I adopt the substance of the findings proposed by the Company and the Vermont Department of Public Service ("Department"). Therefore, I recommend that the Board approve the stipulation and order Waitsfield to adjust its rates to produce revenues of $11,462,618, using the rate design provided in the stipulation, and effective September 11, 2000. I also recommend that unclaimed balances in the 1999 and 2000 DEM weighting reserve funds be refunded to customers at the appropriate time.

II. PROCEDURAL HISTORY

On September 11, 2000, the Board opened an investigation into the Company's rates pursuant to 30 V.S.A. § 226(b), and appointed me as Hearing Officer.[1] I convened a prehearing conference in this matter on September 29, 2000. The Company was represented by Alan B. George, Esq., of Keyser Crowley, P.C. Dixie Henry, Esq., and John J. Cotter, Esq., appeared on behalf of the Department. Roger H. Nishi, VP-Industry Relations, also attended on behalf of the Company. To minimize the burden of litigation for this relatively small company, I encouraged the parties to work actively toward settlement.

A technical hearing was held on January 9, 2001. At that hearing, the Company and the Department submitted a stipulation, dated January 8, 2001 ("the Stipulation") and moved for its adoption by the Board. In the Stipulation, the Company and the Department agreed that the rates resulting from their stipulated settlement are just and reasonable. A proposed Board Order was attached to the Stipulation, as was a cost of service analysis describing the Company's original filing.

At the technical hearing, several witnesses testified in support of the Stipulation. These included Clifford C. Abbott, Jr., Roger H. Nishi, and Daniel P. Owen, on behalf of the Company and John Sayles, Andrea C. Crane, and Thomas H. Weiss, on behalf of the Department.

III. FINDINGS

Based upon the evidence of record and the testimony presented at the hearings, I submit the following findings to the Board in accordance with 30 V.S.A. § 8.

1. On November 1, 2000, the Company filed a cost of service and earnings analysis that calculated the Company's revenues, at present rates, at $13,122,618. Exh. Joint 1, ¶¶ 1-2 at 1; tr. 1/9/01 at 4.

2. The Company and the Department entered a Stipulation, dated January 8, 2001, which is described above. Exh. Joint 1.

3. The Stipulation provides that the revenue requirement calculated by the Company be reduced to $11,462,618 for purposes of settlement. This is a reduction from the Company's filed revenue requirement of $1,660,000.00. Exh. Joint 1, ¶ 3 at 1; tr. 1/9/01 at 10.

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1. Order of 9/11/00.

4. The Department and the Company agreed on a rate design that will produce revenues consistent with this revenue requirement and that are fair to customers. Exh. Joint 1, ¶ 3 at 1, ¶¶ 6-7 at 2.

5. The Department and the Company negotiated the revenue requirement and rate design that were submitted as part of the Stipulation. The Department and the Company agree that the "bottom line" settlement results in a just and reasonable determination of rates. Exh. Joint 1, ¶ 7 at 2; tr. 1/9/01 at 16 (Weiss), 26, 75 (representation of Company counsel), 66 (representation of Department counsel).

6. The Company's annual revenue requirement is $11,462,618. Exh. Joint 1, ¶ 3 at 1; tr. 1/9/01 at 10.

7. The stipulated revenue requirement is based upon the deferred tax analysis ("goodwill") approved by the Board in the Vermont Telephone case (Docket No. 5904, Order of 11/10/97). Tr. 1/9/01 at 70 (representation of counsel).

8. The settlement reflects a balance among the interests of ratepayers in having low rates and allowing the Company to continue to provide excellent service and also to continue to bring advanced services to their customers. Tr. 1/9/01 at 83 (Sayles).

9. The Department and the Company agree that the following changes to the Company's rate design will allow the Company a reasonable opportunity to earn its revenue requirement:

a. The Company shall reduce basic residential service rates from $13.90 to $13.40. Exh. Joint 1, ¶ 4(a) at 2.

b. The Company shall establish a single business rate of $26.40, a reduction from $28.70 in all exchanges except Charlotte, Hinesburg, and Richmond, in which the rate has been $33.50. Exh. Joint 1, ¶ 4(b) at 2.

c. The Company shall reduce its peak rate for local measured service ("LMS") outside the caller's home exchange from the current rate of $0.03 per minute of use to $0.022 per minute of use. Exh. Joint 1, ¶ 4(c) at 2.

d. The Company shall reduce its access rates from $0.086232 by $0.03 per minute to $0.056232. Exh. Joint 1, ¶ 4(d) at 2.

e. The Company will also accomplish some rate consolidation of directory listings and DID rates, make off-premise extension rates uniform, and participate in the Distance Learning Plan developed in Docket 6167. Exh. Joint 1, ¶ 4(e) at 2.

10. The foregoing changes to the Company's rate design, as described above, will result in a rate reduction of 12.65 percent, and the resulting rates will be just and reasonable. Tr. 1/9/01 at 93; findings 1 through 7, inclusive.

11. The Company has agreed to implement the Stipulated Rate Design within two monthly billing cycles after the Board's Final Order approving the Stipulated Rate Design. Following such implementation, over three monthly billing periods, the Company also will promptly refund, to each affected customer, the difference between any charges paid by such customer for telephone services from September 11, 2000, to the date of implementation and the charges each such customer would have paid under the Stipulated Rate Design for the same services during the same period. However, the reduction in access charge rates will be prospective only, and the amount which otherwise would be refunded to interexchange carriers ("access charge refund") will be used by the Company to expedite its DSL roll-out. The Company will file a report with the Department and the Board, six-months and twelve-months following the Board's Final Order approving the Stipulated Rate Design, detailing the progress of DSL roll-out and how access charge refund amounts are being used to bring broadband to consumers earlier than otherwise planned.

12. The Stipulation does not impose any limitations on the ability of the Company or the Department to initiate another rate case. Tr. 1/9/01 at 100.

IV. DISCUSSION AND CONCLUSIONS

The Board opened this investigation into the rates charged by the Company pursuant to 30 V.S.A. Section 226(b). The standard for review of rates, under this section, is whether the rates are just and reasonable. The Department and Company agree that changes to rate design embodied in the Stipulation result in a reasonable determination of the Company's revenue requirement and result in rates that are just and reasonable. Before reaching final conclusions, however, three matters deserve separate discussion.

Cost of Service Summary

Last November, the Company filed a revenue requirement of $13,122,618. The Department has prefiled its direct testimony in this case, but because of the Stipulation that testimony was never brought into evidence. The Department originally proposed a revenue reduction of $3,459,344. The Stipulation produces a revenue reduction of approximately one-half that amount, or $1,660,000. The Company's final stipulated revenue requirement is therefore $11,462,618.

As a part of the Stipulation, the parties brought into evidence a cost of service analysis that supports the Company's November filing and a revenue requirement of $13,122,618. This exhibit thus disagrees with the settlement amount by $1.66 million. At the hearing on the Stipulation, I requested an updated cost of service analysis that agrees with the stipulated revenue requirement. The parties declined to provide this, in large part because they had reached a "bottom line" settlement. They stated that any effort to produce such a document would be at best time consuming and at worst unfruitful.[2]

The lack of a current and accurate cost of service analysis that matches the Stipulation may have at least two undesirable future effects. First, as a result of the settlement, intrastate costs are reduced by $1.66 million, but there will be no parallel interstate cost reductions. Of course, interstate rates are within the jurisdiction of the FCC, not this Board. However, interstate costs of local exchange companies are recovered through fixed charges on retail customers, and thus the question does affect the total rates paid by Vermonters to the Company.[3] Second, the lack of a cost of service summary will deprive the Company and the Department of a guide to future rate cases. In the event of another rate review in the near future, all of the separate issues that have been raised here could still be fully in dispute, and all that will have been produced here is an unexplained difference of $1.66 million from the Company's claims.

Notwithstanding the absence of a cost of service summary, I recommend that the Board adopt the stipulation. I reach this conclusion largely because the Board has a well-established and

2. Tr. 1/9/01 at 78 (Sayles).

3. To the extent that Waitsfield's interstate costs are recovered from fixed customer charges, from the customer's perspective they may be practicably indistinguishable from local exchange charges paid for intrastate costs. The FCC has recently asked for public comment on the "MAG" proposal for incumbent carriers such as Waitsfield. Under the MAG plan, customers would pay a fixed monthly charge to cover their carrier's "non-traffic sensitive" costs. FCC 00-448, Released January 5, 2001.

sound policy to encourage settlement, even where those settlements are of a "bottom line" nature.[4]

Separations

In August of 2000, Waitsfield filed separations factors with the National Exchange Carrier's Association ("NECA") for purposes of establishing its 1999 interstate revenue requirement.[5] This NECA filing was based upon the Company's past separations practices.[6] In the same month, the Company also filed separations factors with the Board for purposes of establishing an intrastate revenue requirement, and this filing included data for a 1999 test year.[7] In November, the Company prefiled testimony in this docket, including a revenue requirement analysis that represented a calendar 1999 test year and a calendar 2000 projected test year.[8]

There were significant differences between the filings at the Board and the filings at NECA.[9] For at least six separations factors, the intrastate factor ("state factor") filed with the Board was higher than the intrastate factor filed with NECA.[10] This created a significant possibility that the Company might recover more than 100% of its just and reasonable costs.

The Company offers two explanations. The first relates to an ambiguity in the rules concerning the FCC's support for local switching costs of small companies. Under FCC rules, local switching support depends upon company size. For companies with less than 50,000 lines, the company's interstate "Dial Equipment Minutes" ("DEM") interstate separations factor is artificially increased, thereby shifting revenue requirement from the intrastate to the interstate jurisdiction. The size of the shift depends upon company size. For companies with more than 20,000 lines, the multiplier is 2.00. For companies with less than 20,000 lines, the multiplier is 2.50, and thus the shift to interstate is larger. In 1997, the FCC slightly changed the rules for calculating this "DEM weighting" benefit. The new formula is based in part on the historic size of the benefit in 1996.

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4. During the early stages of this docket I strongly encouraged settlement, largely in an effort to reduce litigation costs for this comparatively small company.

5. Tr. 1/9/01 at 24 (statement of counsel).

6. Tr. 1/9/01 at 39 (Nishi).

7. Tr. 1/9/01 at 29 (Weiss); *id.* at 116-17 (representation of counsel).

8. *Id*.

9. Tr. 1/9/01 at 24 (statement of counsel).

10. These included the "conversation minutes" and "subscriber line usage" factors. Tr. 1/9/01 at 33-34 (Nishi).

In 1998, Waitsfield for the first time had more than 20,000 lines.[11] At issue has been whether the Company's federal support benefit should be calculated based upon its 1996 size or its current size. The Company maintains that a proper reading of the FCC rules entitles it to continue to use the 2.50 multiplier. In its filing at NECA for the 1999 year, Waitsfield thus claimed a multiplier of 2.50 for the interstate portion of its local switching costs.[12] In its state filings in this docket, Waitsfield used a 2.00 DEM multiplier, and thereby significantly increased its intrastate revenue requirement.

When Waitsfield's intrastate revenue requirement filed here (based on a 2.00 multiplier) is added to the interstate revenue requirement filed at NECA (based upon the 2.50 multiplier), the total thus exceeds 100% of costs. Because NECA has a right to disagree with the Company's 1999 filing until the end of 2001,Waitsfield also has created a reserve account to match its contingent liability to NECA.[13] If NECA should disallow this 2.50 calculation by the Company, the reserve will cover the Company's liability to NECA.

Second, after Waitsfield filed its separations factors with NECA, it recognized "errors" in the underlying separations study.[14] Those alleged errors arose from the methods the Company uses to estimate local minutes of use.[15] The Company's management then concluded that "the adjustments [the Company] made to the original NECA study in terms of local were too large"[16] and "did not make sense."[17] The Company thereupon developed a different methodology based upon the average characteristics of the Charlotte, Richmond and Hinesburg exchanges.[18] These numbers were used as the basis of the Company's November filing at the Board.[19]

In light of the overall "bottom line" settlement of the parties, I recommend that no further investigation be made in this docket into the circumstances surrounding the reporting differences

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11. Tr 1/9/01 at 18 (statement of counsel).

12. Tr. 1/9/01 at 19 (statement of counsel).

13. Tr. 1/9/01 at 17-22 (statement of counsel).

14. Tr. 1/9/01 at 23 (statement of counsel).

15. Some of these minutes are actually recorded as toll minutes, but since they arise over extended area service routes, these minutes should properly be recorded as local minutes. Exh. Waitsfield-1 at 1-2.

16. Tr. 1/9/01 at 35 (Nishi).

17. Tr. 1/9/01 at 40 (Nishi). At that time it appeared that 1999 local minutes of use had increased too much in the Bristol and Weybridge exchanges. *Id.* at 41.

18. Exh. Waitsfield-1 at 2-3.

19. At the hearing in January, the Company maintained that once it made corrections to its state filing it should have corrected its NECA filings. Tr. 1/9/01 at 35-36, 104 (Nishi). Waitsfield had not done so by January 9, 2001, but it plans to do so in the future. Tr. 1/9/01 at 43 (Nishi), 115 (representation of counsel).

between the Company's state filings and its NECA filings. The Department has conducted a thorough analysis of these differences, and its judgment should receive deference. Nevertheless, I include a discussion of the separations issues here for three reasons, each of which requires some action by the Board, staff or the DPS.

The first reason for discussing separations here is a broad concern affecting the conduct of future rate cases involving independent telephone companies. State ratemaking for local exchange companies is undergirded by a fundamental assumption of congruent reporting. That is, for each separations factor, the Board assumes that the intrastate separations factor reported to the Board is equal to 100 percent minus the interstate factor reported to NECA. If reports are not congruent, the Company will earn more or less than its allowed rate of return on its entire investment and operations.

In this case, the Department undertook to examine both federal and state separations reports, and it found an apparent violation of the congruence principle that could lead to recovery of more than 100% of the Company's revenue requirement. The Company has now explained that apparent violation to the satisfaction of the Department. Because of the possibility that this problem may be more widespread, I recommend that the Board routinely include a thorough separations analysis in future rate cases that involve independent telephone companies.

The Department has concluded that, solely for purposes of the settlement and on a "going forward" basis, the proper DEM weighting factor for Waitsfield to use for intrastate ratemaking purposes is 2.00 and not 2.50.[20] The Department made this recommendation knowing that it increases the Company's intrastate revenue requirement.[21] The second reason for discussing separations here is to evaluate the reasonableness of this conclusion, both in the context of making a decision on the Stipulation and also with regard to the need for future rate reviews.

Contrary to the DPS's assertion, I conclude that it is very likely that the Company's interstate revenue requirement will be set for the foreseeable future using a weighting factor of 2.50, not 2.00, and, therefore, state ratemaking should be based upon the same 2.50 weighting factor, thereby producing lower intrastate rates. My conclusion is based upon an apparent inconsistency between two FCC rules, one in "Part 36" relating to separations, the other in "Part 54" relating to universal service.

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20. Tr. 1/9/01 at 95 (representation of counsel).
21. Tr. 1/9/01 at 94 (representation of counsel).

In both instances, the critical question is how the rules would treat the situation of a company that in 1996 had fewer than 20,000 lines but today has more than 20,000 lines. The relevant universal service rule is section 54.301. Subsection (a) of that rule contains an explicit provision dealing with exactly the question here and directs that the company's "local switching support factor" be reduced because of post-1996 line growth.[22] As a result, universal service support for Waitsfield's local switching cost is decreased by the current line count, and universal service support is based upon the 2.00 multiplier. This much is consistent with the Department's conclusion.

However, Part 36 establishes the rules for separating the Company's costs. The Part 36 rule not only fails to refer to subsequent changes in line counts, but it explicitly refers to the 1996 factors.[23] In other words, the 1996 line counts, and thus a 2.50 weighting for Waitsfield, appear to be still locked in under Part 36. The effect seems to be that Waitsfield's interstate revenue requirement remains based upon a 2.50 weighting, regardless of its universal service support.

In summary, the two rules, read together, seem to say that as a result of Waitsfield having grown larger than 20,000 lines, its universal service support should decrease, but its total interstate revenue should not decrease. In other words, it appears that line growth changes the source of some revenue, but not the total. If this conclusion is correct, the Board should also base state rates upon the assumption of no decrease in interstate revenue, and hence should use a 2.50 multiplier, not a 2.00 multiplier.

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22. Subsection (a) of section 54.301 reads as follows:

(a) Calculation of local switching support.

(1) Beginning January 1, 1998, an incumbent local exchange carrier that has been designated an eligible telecommunications carrier and that serves a study area with 50,000 or fewer access lines shall receive support for local switching costs using the following formula: the carrier's projected annual unseparated local switching revenue requirement, calculated pursuant to paragraph (d) of this section, shall be multiplied by the local switching support factor. For purposes of this section, local switching costs shall be defined as Category 3 local switching costs under part 36 of this chapter.

(2) Local switching support factor.

(i) The local switching support factor shall be defined as the difference between the 1996 weighted interstate DEM factor, calculated pursuant to Sec. 36.125(f) of this chapter, and the 1996 unweighted interstate DEM factor.

(ii) *If the number of a study area's access lines increases such that, under Sec. 36.125(f) of this chapter, the weighted interstate DEM factor for 1997 or any successive year would be reduced, that lower weighted interstate DEM factor shall be applied to the carrier's 1996 unweighted interstate DEM factor to derive a new local switching support factor*. (Emphasis added.)

23. Rule 36.125(f) defines the interstate allocation for local switching as the "lesser of .85 or the sum of the interstate Dem factor specified in para (a) (5) of this section and the difference between the *1996 weighted interstate dem factor and the 1996 interstate dem factor*." (emphasis added.)

The revenue requirement difference between a 2.00 and a 2.50 multiplier, according to the Department's estimate, is between $0.4 and $0.5 million.[24] This is approximately four percent of the Company's total revenue requirement.

If this analysis is correct, the Department may have settled this docket in the mistaken belief that the Company's intrastate revenue requirement should be based upon the Part 54 rule, not the Part 36 rule. This would have implications both for the Stipulation and for future revenue requirements of the Company.

I do not recommend rejecting the Stipulation on the basis of the above analysis. The parties did not brief this issue, and therefore the analysis, which is based only on FCC rules, may be illogical or may have overlooked some other important source document.[25] Accordingly, I do not conclude that this analysis provides a sufficient basis to reject the Stipulation. I recommend that the Board accept the settlement and apply it, according to its terms, retroactively to the date this docket was initiated.

Despite the limited weight accorded this analysis, however, I do think that the question should be finally resolved. I recommend, therefore, after the final order is issued in this docket, that informal discussions commence promptly among Board staff, Department staff and the Company. Those discussions should seek a consensus on the proper application of the Part 36 and Part 54 rules, and thus the proper parameters to estimate the Company's interstate revenue requirement. If Board staff or the Department conclude that the 2.50 factor should apply to state ratemaking proceedings, the Department may wish to recommend, or the Board may wish to initiate, still further proceedings concerning Waitsfield's rates.

The third reason to discuss separations here is to determine what should happen to any unclaimed balances in Waitsfield's DEM reserve funds. As explained above, the fund for calendar 1999 arises from a contingent liability to NECA relating to reporting the DEM weighting factor in 1999 at 2.50. NECA may audit, and must make any objections to, such a filing by the end of the second calendar year following the reported year.[26] Therefore, after the end of 2001, if NECA has not challenged the 1999 filing, the contingent liability giving rise to the 1999 DEM reserve

24. Tr. 1/9/01 at 98 (Weiss).

25. There may, for example, be interpretive rulings from the FCC on this issue that are not in the record.

26. Tr. 1/9/01 at 20 (statement of counsel).

fund will expire. The difference between the 2.00 and 2.50 multiplier was estimated at between $0.4 and $0.5 million,[27] and this should be the size of the contingent liability.

Because 1999 was the test year in this docket, the Department examined the Company's 1999 filings at NECA. Waitsfield's counsel has also asserted, however, that Waitsfield's management continues to believe that the 2.50 weighting is proper and should be preserved.[28] Therefore, it seems highly likely that a similar contingent account exists for the 2000 calendar year. If so, the same issues apply to the 2000 DEM reserve fund.

The Board should decide whether the 1999 DEM reserve fund, should it remain unclaimed by NECA at the end of 2001, and any similar 2000 DEM reserve fund, should be refunded to ratepayers. The parties did discuss related issues, but the disposition of the reserve funds was not covered by the Stipulation nor was it explicitly discussed at the hearings. Accordingly, the parties may have intended that the Company retain these funds.

Waitsfield consistently maintained, however, that the DEM reserve fund is for ratepayer benefit.

> It's to the benefit of Vermont ratepayers that this company continue to get the high level of interstate support, revenue support that it historically has gotten. Obviously if we file at [sic] using 2.0 DEM weighting factors, significant revenue requirement for this company shifts to the intrastate side. And we will have to look to our customers' basic rates to pay the difference.[29]

The nature of these intended benefits, however, is not clear from the record. The Company seems to have a broad view of how money may be spent for customer benefit:

> And the company's position has been that it would roll that money into customer benefits as it really is being used and has been used to benefit the company, and therefore, its customers and its shareholders indirectly from the beginning. But it would use that money after the two-year window closed.[30]

In reaching a recommendation to the Board, I find it of central importance that the Company consistently characterized the DEM reserve funds as existing to provide ratepayer benefits. Consistent with the Company's representations, I recommend that the Board condition

27. Tr. 1/9/01 at 98-99 (Weiss).

28. Tr. 1/9/01 at 21 (statement of counsel)("Mr. Nishi wants to protect and preserve the company's eligibility for the 2.5 DEM weighting for very practical and good reasons.").

29. Tr. 1/9/01 at 21 (representation of counsel).

30. Tr. 1/9/01 at 22-23 (statement of counsel).

acceptance of the Stipulation upon agreement by the Company to utilize all unclaimed reserve amounts to the benefit of ratepayers. Since a refund is the most direct of all possible customer benefits, I recommend that disposition. The appropriate time for a refund of each reserve fund would be as soon as possible after the contingent liability to NECA expires.

In summary, I recommend that the Board condition approval of the Stipulation upon:

(1) Waitsfield refunding to customers in January of 2002, all funds in the 1999 DEM reserve fund that have not been claimed by NECA by December 31, 2001; and

(2) Waitsfield refunding to customers in January of 2003, all funds in the 2000 DEM reserve fund, if it exists, that have not been claimed by NECA by December 31, 2002.

Management Costs

The Order opening this Docket recited a possible concern with the size of Waitsfield's corporate operations expense.[31] I discuss the question here to assure the Board that the Department has conducted a sufficient investigation on this point and that the Board should accept the Department's Stipulation.

Waitsfield obtains all management services through a contract with its parent company, Selectronics, Inc.[32] When a regulated company obtains management services from an affiliated enterprise, concerns arise that ratepayers of the Company's monopoly telephone service may be forced to subsidize the costs of other unregulated affiliates. The Board has repeatedly expressed concerns about such affiliate relationships.[33] The Board's concern must be particularly acute

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31. Docket No. 6417, Order of 9/11/00 at 2.

32. This arrangement was created when Champlain Valley Telecom was acquired in the 1990's, to allow allocation of management time to the two companies. Later, the two study areas were merged, but the arrangement was maintained as a convenient way to allocate management costs over other unregulated enterprises including Green Mountain Access, the Company's Internet company and Green Mountain Long Distance, its toll service provider. Tr. 1/9/01 at 43-44 (Nishi).

33. *See* Docket No. 5001, Tariff filing of New England Telephone and Telegraph Company, Order of 12/13/85 ("Traditionally, three tests have been used in regulating affiliate transactions. 1. Comparison of the price at which the firm made purchases from its affiliates with the price at which it could have obtained comparable products or services from other sources. 2. Comparison of the price at which the affiliate sold the products or services to the regulated firm with the price at which the affiliate sells comparable products and services to non-affiliated firms. 3. If the affiliate does not sell in a competitive market, but instead exercises a degree of monopoly power, the test limits the costs of purchases from affiliates allowed in the firm's revenue requirements to the affiliate's costs of providing the products or services, including a reasonable rate of return."); Docket No. 5407, Investigation of New England Telephone & Telegraph Company Affiliated Transactions With NYNEX Materiels Enterprises Company, Order of 7/11/95 (adopted eight stringent rules for affiliate transactions by NYNEX); Docket 5797, Investigation of Appropriate Principles for Governing Affiliate Transactions Between Central Vermont Public Service Corporation

(continued...)

when, as here, the affiliated group engages in lines of business that are not subject to rate regulation.

The Department's examination of the management contract and overall corporate operations expense questions appears to have been thorough.[34] Waitsfield has not independently valued the Selectronics management service, but Selectronics employees working for Waitsfield do keep time reports, by company served, and Selectronics conducts periodic management compensation studies.[35] Moreover, the Company's practice of maintaining detailed time records gives some incremental assurance that the Company is not subsidizing its unregulated operations with revenues from captive ratepayers. I conclude, therefore, that corporate operations expenses have been sufficiently investigated and that the Department's Stipulation provides a sufficient basis to conclude this docket.

V. Conclusion

I have reviewed the Stipulation and the evidence provided in support of it. I have also reviewed the Board's opening order and the cost of service and earnings analysis filed by the Company, and I have considered the responses of the Company to my questions and those posed by the Department. In particular, I questioned the Department on why it has settled for a revenue reduction approximately one-half of what it claimed in prefiled testimony.[36]

Based on my review of the evidence, I believe that the final "bottom line" settlement amount represents a plausible outcome of this case, if it had been tried to a conclusion, except as to the existence of DEM reserve funds for 1999 and 2000. I concur with the parties' position that a revenue requirement of $11,462,618 is just and reasonable and that the changes to rate design presented in the Stipulation are also just and reasonable. I also recommend that unclaimed

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33.(...continued)
and its Affiliates, Order of 1/17/95 at 1 ("Under existing regulatory structures, ratepayers are the captive customers of a monopoly utility provider. The utility's regulated cost of service becomes inflated at the ratepayers' expense, if, in the course of transactions with affiliates, the utility either (1) is subject to costs that are too great, or (2) fails to receive adequate revenue for the services it renders.")

34. The Department prefiled testimony proposing some adjustments to corporate operations expense. In light of the settlement, that testimony was never introduced, and was never cross-examined.

35. Tr. 1/9/01 at 46 (Nishi). The result is that Selectronics has total expenses of $8.9 million, of which $7.7 million is allocated to Waitsfield Telephone, and the remainder to other affiliated enterprises providing cable TV, voice mail, long distance, Internet, and other non-regulated services. At least two of these other enterprises have separate full-time management employees. Tr. 1/9/01 at 50-51 (Nishi), 52 (Abbott).

36. *See* tr. 1/9/01 at 91-100 (representation of counsel).

balances in the 1999 and 2000 DEM reserve funds be refunded to customers at the appropriate time. I also recommend that discussions be commenced immediately following issuance of the Board's final order in this docket to clarify the appropriate DEM weighting factor to use in state ratemaking. In reaching these conclusions, I rely in part upon the expertise and judgment of the Department's staff, and the depth of their knowledge about the Company's obligations, operations and finances.

By Stipulation, the Company and the Department agreed to waive their rights under 3 V.S.A. § 811 to file exceptions, present briefs, and make oral argument, in the event this Proposal for Decision is substantially in the form attached to the Stipulation. Because this proposal varies from the parties' proposal regarding refund of the DEM contingent liability account and regarding continued discussions of the DEM weighting factor, it has been circulated for comment to the parties. The parties have submitted written comments, and I have reviewed those comments.

DATED at Montpelier, Vermont, this 28th day of March, 2001.

s/Peter M. Bluhm
Peter M. Bluhm,
Hearing Officer

VI. BOARD DISCUSSION

We agree with the findings and conclusions of the Hearing Officer. We do not fully adopt, however, the Hearing Officer's recommended method for disposing of the DEM reserve funds. We write here to explain our decision in that matter.

The 1999 DEM reserve fund was estimated at approximately $400,000 to $500,000. It reflects the difference in 1999 interstate costs for local switching based upon a 2.50 interstate weighting, minus the costs using a 2.00 interstate weighting factor. There appears to be a similar fund for the year 2000, and it is presumably of approximately the same size, although the record is silent on this point.

As the Hearing Officer noted, Waitsfield has asserted throughout this docket that this money is for the benefit of Vermont ratepayers. The Company has maintained this position even in recent correspondence where it noted the possibility "that one or more opportunities to use the funds for the direct benefit of ratepayers will emerge . . . ."[37]

We agree with Waitsfield and the Hearing Officer that this money should be used for the benefit of ratepayers. We disagree with the Hearing Officer, however, in his conclusion that the best use for this funding is a refund. We also note the disagreement between the parties as to whether these funds, which arise from operations in 1999, may be applied to offset a hypothetical revenue deficiency in future years. We need not decide that question today.

It is enough here to note that Waitsfield has explained that the 1999 contingency fund will be recognized as revenue in January 1, 2002, so long as it remains with Waitsfield; and likewise the 2000 contingency will be recognized in January 1, 2003. We can decide at those times, when the income is recognized, whether a proposed method of providing benefit to ratepayers is suitable.

We therefore direct Waitsfield to file a plan to dispose of each of the contingency accounts. Of course no plan is needed if NECA should have successfully claimed those funds previously. A mere notice of that fact will suffice. Assuming the contrary, however, the plan for the 1999 fund should be filed not later than January 5, 2002. This date will follow shortly upon

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37. Letter of March 21, 2001, from Alan B. George to Peter Bluhm.

the expiration of the contingent liability to NECA. The plan for the 2000 fund should be filed not later than January 5, 2003.

In deciding what kind of customer benefit to propose in 2002 and 2003, we direct Waitsfield to consider proposing direct refunds to current customers. Waitsfield may, however, propose a different mechanism by which affected ratepayers would derive benefits equivalent to the overcollection.[38]

VII. Order

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The findings and recommendations of the Hearing Officer are adopted, and his recommendations and conclusions are affirmed, except as noted above.

2. The Stipulation between Waitsfield-Fayston Telephone Company, Inc., and the Vermont Department of Public Service dated January 8, 2001, is approved. This approval is conditional upon:

(a) Waitsfield-Fayston Telephone Company, Inc. filing a plan by January 5, 2002 concerning a method of providing the benefit to customers of all funds in the 1999 DEM reserve fund that have not been claimed by NECA as of December 31, 2001; and

(b) Waitsfield-Fayston Telephone Company, Inc. filing a plan by January 5, 2003 concerning a method of providing the benefit to customers of all funds in the 2000 DEM reserve fund that have not been claimed by NECA as of December 31, 2002.

3. Waitsfield-Fayston Telephone Company, Inc., shall file its revised tariff rate pages incorporating the rates contained in the Stipulation within 30 days from the date of this Order.

4. This docket shall remain open until final disposition of the 1999 and 2000 DEM reserve funds.

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38. For example, the Board has looked favorably upon company-initiated programs by Verizon and Adelphia that provided high-speed connections to schools and libraries that facilitated internet access and distance learning.

DATED at Montpelier, Vermont, this 2nd day of April, 2001.

s/Michael H. Dworkin	)	
	)	PUBLIC SERVICE
s/David C. Coen	)	BOARD
	)	OF VERMONT
s/John D. Burke	)	

OFFICE OF THE CLERK

Filed: April 2, 2001

Attest: s/Susan M. Hudson
Clerk of the Board

Notice to Readers: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or mail) of any technical errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.